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SUBJECT: Congress Rolls Back Correa's Controversial Banking Law

REF: A. Quito 999

¶B. Quito 1422
¶C. Quito 1424

¶1. (SBU) Summary. The Ecuadorian Congress rejected for the third time proposals by Correa to impose strong political control over interest rates, bank fees, reserve requirements, and a liquidity fund. The Congress substantially modified Correa's bill to establish more limited controls, which the banking sector found relatively acceptable. When Correa used his partial veto authority to again seek stronger controls, Congress mustered the two-thirds majority necessary to override the veto and restore the key measures from its version of the bill. End summary.

Correa Seeks to Politicize Banking Regulation

¶2. (SBU) On May 18, President Correa sent a draft law to Congress to reform key institutions and regulations for the banking sector. The highly ambitious law attempted to implement Correa's campaign promises to limit the cost of loans and force banks to repatriate their overseas holdings. The key element of the bill was to give greatly increased power over the banking sector to the Bank Board, taking those powers away from the autonomous Central Bank and the Superintendency of Banks. The Banking Board is in effect a political institution, since Correa has directly appointed two of its five members and effectively appointed a third (reftel a). Among its many provisions, the law would have given the Banking Board the authority to set interest rates and reserve requirements and control over a liquidity fund. It would have also eliminated the bank's ability to charge commissions in addition to interest rates, and would have allowed the Banking Board to set bank service fees.

¶3. (SBU) The banking community strongly lobbied in Congress against the bill, joined by the Central Bank and Superintendency of Banks, who also argued that the bill would reduce lending, particularly to small borrowers. (Ecuador has one of the region's most dynamic microcredit industries, and the interest rate caps would likely have dramatically curbed activity in that sector.) Representatives from the Superintendency of Banks presented scenarios showing how Correa's proposed law would affect the stability of the financial sector and cause some institutions to fail. They claimed the law would greatly increase the possibility of a systemic failure if depositors panicked and withdrew their savings and investments from the banks.

Congress Moderates the Bill

¶4. (U) On June 14, Congress substantially changed the legislation, rejecting most of the new authorities that would have gone to the Banking Board. It left the power to set maximum interest rates with the Central Bank. It modified Correa's proposal to set maximum interest rates segmented by national accounts (for example, agriculture, industry, commerce, mining) to one divided by commercial, housing, consumer and microfinance segments. This would give the financial sector greater flexibility to differentiate between types of loans. Congress also defined the methodology the Central Bank should use in setting the maximum interest rate (the weighted average of the loan rates by segment plus two standard deviations) instead of giving it discretional authority to modify the methodology as Correa had proposed.

¶5. (U) Congress's version of the law also left with the Central Bank its authority to set reserve requirements, and gave the private sector the authority to create and manage a liquidity fund since there is no lender of last resort. It also stipulated that fees for other services (checks, ATM withdrawals, etc) would have a maximum price equivalent to the average charged by the system plus two standard deviations. Congress accepted Correa's proposal to eliminate commissions on loans.

Correa Seeks to Reimpose Stronger Controls

¶6. (U) On June 25, Correa exercised his right to partially veto the bill approved by Congress, and attempted to restore some of the authorities that Congress had stripped from his draft. Most notably he sought to reduce the maximum interest rate by limiting it to the average interest rate plus only one standard deviation. He also sought to restore greater power to the Banking Board, including the ability to further control interest rates, establish maximum banking fees, and to oversee a liquidity fund.

Congress Overturns Most of Correa's Vetos

¶7. (SBU) Banks once again lobbied Congress strongly against the partial veto, and urged Congress to exercise its right to insist upon the version that it had approved. This time around, the Superintendency of Banks and the Central Bank remained silent (note: the Superintendent of Banks was under a congressional censure motion, which failed on July 4, while Central Bank management was changing following the resignation of the Central Bank Manager). Even so, a number of banking contacts were skeptical that Congress could overturn Correa's partial veto, since that would require a two-thirds majority.

¶8. (U) On July 5, after previously failing to override all of Correa's changes in one vote, Congress considered Correa's changes item-by-item, and for the most important measures (maximum interest rates, liquidity funds, bank fees) secured the two-thirds majority necessary to restore the version that had been approved by Congress. On July 18, Congress reached consensus on the final controversial measure, how to set the maximum interest rate, overturning the President's partial veto.

¶9. (SBU) The banking sector responded in both the media and to embassy contacts that while it had reservations with the version passed by Congress, it believes that it could live with the provisions. The Executive President of the Banking Association said he had reached agreement with members of Congress to lower the costs of financial services in exchange for their support on the law. In a meeting with USAID June 19, Ecuador's four financial associations informed us that they have already started an aggressive campaign to reduce interest rates in the financial institutions that they represent. They believe that if interest rates are not reduced in the short term, Correa will use the Constituent Assembly to take control the financial sector and make changes, as he has publicly stated.

Comment

¶10. (SBU) Correa had a legitimate beef about overly high rates and commissions in certain loan segments, but his proposed prescription exceeded the diagnosis and would have created a new set of problems and concerns. Congress rejected three times the key provisions that

Correa sought in order to impose greater political control over the banking sector. This follows earlier Congressional measures to reject Correa initiatives (reftels b and c). The banking sector has breathed a sigh of relief that it was able to find enough allies in Congress who share its arguments that Correa's provisions would harm small borrowers and potentially damage the sector. However, the sector is still concerned about the law's lack of clarity regarding the methodology to establish the maximum interest rate. Banks are also concerned that under the existing formula interest rates would move towards a fixed rate within six to eight months. Since commissions are no longer permitted, some institutions might show losses until they are able to adjust their cost structures, requiring intervention by the Superintendency of Banks. The banks also believe that this is a temporary truce, since Correa has already stated that he will bring the banks under control through the upcoming Constituent Assembly.

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